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SENSITIVE

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TAGS: ENRG ECON EPET CA
SUBJECT: CANADIAN VIEWS OF HURRICANE KATRINA ENERGY SUPPLY DISRUPTIONS: GREATEST RISK MAY BE THE POLICY RESPONSE

REF: STATE 163206

¶1. (U) This message is sensitive, but unclassified. Not for distribution outside USG channels.

SUMMARY/INTRODUCTION

¶2. (SBU) In the wake of Hurricane Katrina, the Government of Canada (GOC) has pledged its support through the International Energy Agency to increase oil supplies by 91,000 barrels per day, much of which will find its way to U.S. markets. Federal and provincial officials are exploring further ways in which Canada can increase petroleum supplies. In the private sector, Canadian energy sector leaders say that while their industries have had few immediate difficulties responding to the repercussions from the hurricane disaster, there is very little they can do to relieve the pressure on prices given the pre-existing tight market conditions. With a federal election expected this winter, they worry that a "perfect storm" of political conditions will lead to ill-considered promises and intrusive policies by the Canadian government. End summary/introduction.

GOC RESPONSE

¶3. (SBU) The GOC has pledged to increase petroleum supplies by 91,000 barrels of crude oil per day, representing about 4.6 percent of the two million barrel per day increase agreed to by member nations of the International Energy Agency. This is in addition to the approximately 1.6 million barrels of oil per day which Canada already supplies to the United States. Total Canadian petroleum production is about 3.1 million barrels per day, and domestic consumption is about 2.3 million barrels per day (the difference is due to Canadian oil imports of about 800 thousand barrels per day).

¶4. (SBU) According to a contact at Canada's Department of Natural Resources, or NRCan, the federal government is exploring a variety of options to increase supplies available for the United States. About one-third of the extra 91,000 barrels per day, or 30,000 barrels, will come from production increases in Alberta, whose provincial Energy and Utilities Board has already approved the increased production. Among other possibilities to enhance output in the Canadian oil patch are changes in well pressure to increase the flow of petroleum to the surface, and postponing or delaying scheduled maintenance or upgrades on refineries so that production may continue unabated.

¶5. (SBU) The NRCan official cautioned, however, that Canadian production is already near its maximum, given constraints on refining and transportation. Conservation, therefore, will also play a key role in making available a considerable portion of the extra 91,000 barrels per day. With retail gasoline prices in Canada reaching as much as C$1.30 per liter (C$1.00 equals $.80 U.S.), the official noted that there should be some short-term demand reduction as many consumers reduce their gasoline consumption, which should free up additional supplies.

INDUSTRY VIEWS: "A PERFECT POLICY STORM"

¶6. (SBU) Emboffs spoke with a range of Canadian energy industry representatives, who made the following key points:

There was a pre-existing demand peak in energy markets, so most energy supply systems in Canada were already near capacity before the hurricane. Nevertheless, producers are doing whatever they can to increase the flow. Industry-to-

industry contacts have enabled more effective transmission of oil and gas throughout the North American distribution system, and for the most part the energy trade between Canada and the United States has not been affected by the hurricane.

-- Canadian chemical producers are strongly reliant on natural gas supplies and they say they have little capacity to pass on cost increases to their customers. In their view, the post-hurricane situation highlights the relative isolation of North American gas markets from overseas suppliers. They expect the spike in natural gas prices to create real disconnects in supply chains. Safety concerns, they stress, slow down the process of re-starting plants in this industry once they go down.

-- Our contacts expected high energy prices to continue into the winter heating and lighting season, when the combined effect of higher gasoline, heating fuel and electricity costs will likely create real pain for many Canadian households. Historical experience suggests that consumer habits will take years to respond to these price increases, so demand will not abate much this winter.

-- In the expected late fall or winter election campaign, the parties will be under severe pressure to promise voters relief from high energy prices. Even sympathetic politicians have told our industry contacts that they will have difficulty withstanding such pressure. The risk of what our contacts call "ill-considered promises" is very high.

-- The broader economic impact of energy price spikes on Canada's macro-economy is fairly clear. There is a short-run boost to GDP in the producing regions (chiefly Alberta) and to government tax revenues. However, this is somewhat exceeded by the negative effects later on as other sectors suffer and the price increases work their way through to the consumer price index.

COMMENT: CANADA'S POLITICS OF ENERGY

¶7. (SBU) The governing Liberal Party is shaky, hampered by a major scandal and by the fact that it commands only a minority of legislative seats. An election is expected sometime during the coming winter. The Liberals are desperate to regain a majority in Parliament and they have a well-established habit of shifting to the left when campaigning. Further, there is precedent for massive government intervention in the energy sector: From 1980-1984, the GOC attempted to limit oil exports in order to keep domestic prices below world levels. This now-infamous "National Energy Policy" created lasting inter-regional resentments by transferring billions in wealth from oil-producing Alberta to the industrial heartland in Ontario and Quebec.

¶8. (SBU) Comment, continued: While Alberta and the energy industry remain vigilant against a return to interventionist policies, we see signs that Canada's economic policy pendulum has been tending in that direction. Hurricane Katrina may have given that pendulum a further nudge, especially as confidence in, and understanding of, market forces seems particularly weak where energy is concerned. A majority of Canadians believe that gasoline prices are manipulated by major oil firms, and a poll of 1500 Canadians taken during the last week of August (before most of the hurricane's effects were felt) found that 49 percent of respondents favored nationalizing petroleum resources.